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Structuring Memorandum

This memo addresses three paths[1] (the "Options") to address issues associated with that certain Amended and Restated Power Purchase Agreement, dated December 31, 2014 (the "PPA"), between JEA and the Municipal Electric Authority of Georgia ("MEAG") in connection with JEA's strategic review process.

Threshold Issue

We want to briefly flag a litigation risk relating to any transfer of assets by JEA. This risk, which applies to all three Options, arises under Section 307 of the PPA, the language of which reads as follows:

> Section 307. Buyer hereby covenants and agrees that it shall establish, maintain and collect rates and charges for the electric service of its Electric System so as to provide revenues sufficient, together with available Electric System reserves, to enable Buyer to pay to MEAG all amounts payable under this Agreement and to pay all other amounts payable from and all lawful charges against or liens on the revenues of its Electric System.

This provision can be interpreted in a manner that would accommodate each of the Options without needing approval of MEAG, the Project J Bond Trustee, the DOE, and/or the Collateral Agent under the DOE loan. Given the ongoing litigation with MEAG, however, we should anticipate that MEAG may argue that Section 307 blocks *any* sale of *any* asset of JEA's Electric System without the consent of MEAG, the Project J Bond Trustee, the DOE, and/or the Collateral Agent under the DOE loan.[2] By asserting this claim, MEAG might be able to tie up privatization of JEA in the courts, even if the court ultimately rules against MEAG on the merits.

There are steps that can be taken to strengthen JEA's position. In order to take advantage of a safe harbor provided for in JEA's General Debt Obligation Bond Resolution, which defines the term "Electric System" as used in Section 307 of the PPA, the legal JEA entity can retain just over 10% of the assets of JEA, post-transaction. These assets might include a small portion of JEA's transmission and distribution hardware.[3] JEA could also obtain a guarantee from the City of Jacksonville (the "COJ"), enter into a credit support enhancement agreement backstop its

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[1] We also assessed whether JEA could transfer the PPA to the City of Jacksonville or any other party. Section 1001 of the PPA, however, bars JEA from making such an assignment without MEAG's consent. In any event, all or most of the benefits of assignment can be achieved without transferring the PPA to the COJ.

[2] This argument would be based upon the definition of "Electric System," which is incorporated by reference from the JEA General Debt Obligation Bond Resolution (dated May 2012), *not* the PPA itself. This definition states that "Electric System" shall mean the *existing* electric generating, transmission and distribution system consisting of the *existing* generating plants and transmission and distribution lines and facilities together with any and all improvements, extensions and additions thereto …" [emphasis added] Accordingly, MEAG could argue that Section 307 prohibits *any* sale of the existing Electric System assets without its consent.

[3] To minimize the potential impact on any potential purchase price paid for JEA of it retaining these assets, JEA could enter into an agreement with Newco under which Newco would manage these in return for a management fee that enabled Newco to achieve all or most of the benefits of owning the assets that are retained by Newco.

obligation to make payments under the PPA, or establish a large set aside to further assure adequate funds are available to pay MEAG.

Option 1 – Continued Sales to Current Electricity Customers

Overview

JEA retains the PPA and provides service to its current electricity customers for the limited purposes of delivering power purchased under the PPA on an as available basis. Specifically, under this approach:

- JEA is obligated to sell all the power it purchases under the PPA to electricity customers in its current service territory;
- The COJ grants a franchise to Newco, obligating Newco to meet all the remaining electricity requirements of electricity customers in the same service territory;
- JEA sells all or nearly all of its existing assets, except for the PPA, to Newco;
- JEA enters into a delivery services agreement with Newco, under which Newco is obligated to allow JEA to use the transmission and distribution assets Newco acquires from JEA to deliver power from Vogtle;
- JEA and Newco enter into a billing and collection agreement, under which a line item, corresponding to a special charge adequate to cover the full amount of JEA's costs under the PPA, would be added to the Newco bill;
- Newco is responsible for collecting this special charge and remitting the amounts collected to JEA; and
- The billing and collection agreement includes a true-up/adjustment mechanism to ensure that there is no shortfall in the total amounts paid to JEA.

Benefits

- There is no assignment of the PPA and Section 1001 of the PPA is not violated.
- JEA is able to recover 100% of its costs under the PPA. There is no shortfall for JEA to make up.
- 100% of the power will be sold directly by JEA to end-use electricity customers served by JEA (a public entity), rather than to investor-owned utilities, competitive retail suppliers, or other privately-owned wholesale buyers. As a result, there is no private use

and, therefore, no violation of the tax exempt/tax-advantaged status of the Project J Bonds issued by MEAG.[4]

- There does not appear to be any statutory bar that would prevent the Florida PSC (the "PSC") from approving the arrangement.

- Payments are made by end-use electricity customers, not Newco. As a result, Newco should not reduce the price it is willing to pay for JEA's assets.

Issues

- MEAG may claim such structure violates one or more provisions of the PPA and seek to prevent, impair, or delay the consummation of the transaction.

- Certain regulatory approvals must be obtained, as discussed further below.

Steps to Implement

1. Revise JEA's Charter to reflect the change in JEA's role described above.

2. Negotiate and finalize a Franchise Agreement between the COJ and Newco.

3. Obtain City Council approval for revisions to the JEA Charter and for the Franchise Agreement.

4. Negotiate and finalize a requirement or tariff allowing JEA to use the transmission and distribution system Newco acquires from JEA to deliver electricity purchased under the PPA to electricity users in Jacksonville.

5. Negotiate and finalize a collection and billing agreement between JEA and Newco.

6. Develop a proposal regarding how charges under the PPA should be allocated among customers.

7. Potentially negotiate and finalize a "territorial boundary agreement" between JEA and Newco, specifying the respective roles of each entity in serving and-use electricity customers in Jacksonville.[5]

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[4] It is estimated that the potential liability for remediation costs of violating the tax-exempt/tax-advantaged status would be $778 million.

[5] If such an agreement becomes necessary, both JEA and Newco would be responsible for serving the same territory (i.e., the territory currently served by JEA). The responsibilities for serving end-use customers would be allocated between JEA and Newco in the same way as under the Franchise Agreement.

Required PSC Approvals

There does not appear to be any statutory requirement to obtain PSC approval in order to put in place the structure described above. Under Florida law, however, Newco will become a public utility subject to comprehensive regulation by the Florida PSC. This gives the PSC at least the following four regulatory hooks it can use to block privatization if it chooses to do so:

1. Newco will be required to file a rate case before the Florida PSC and to obtain PSC approval for Newco's rates before it can begin operating.[6]

2. PSC approval is needed or Newco to include the special charge provided for under its billing and collection agreement with JEA.

3. PSC approval also is required to determine how costs under the PPA are allocated between customers.

4. The PSC may require JEA and Newco to enter into a "territorial boundary agreement" specifying the respective roles of each entity in serving end-use electricity customers.

Even if these hooks did not exist, Newco will likely insist upon regulatory "buy-in" prior to signing and/or closing any potential transaction. Based upon our initial discussions with the PSC staff, the prospects for PSC approval appear to be reasonably good. In this regard, an important next step is for Chris Kise to meet with the PSC informally, which we understand he plans to do August 14th. We have worked with him on talking points that should be extremely helpful in his discussions with the PSC.

Option 2 – Sales to Investor-Owned Purchasers

Overview

JEA retains the PPA and sells the power it is obligated to purchase under the PPA to investor owned utilities, competitive retail suppliers, and/or other privately-owned wholesale buyers.

Prior to our work this past week, our assumption was that engaging in such sales would violate the status of the Project J Bonds issued by MEAG, which bar "private use" of power purchased from the Project. On an net present value basis, JEA's liability as a result of breaching such status could be as much as $778 million.[7]

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[6] If the PSC refuses to approve the minimum rates Newco believes are necessary for its investment, Newco may refuse to close any potential transaction.

[7] Of this amount, a total of $376 million would be due to the loss of the tax-exempt status of the tax-exempt bonds. The remaining $402 million would be due to the loss of the rebates on the Build America Bonds. If MEAG were willing to defease the bonds, the total present value of the tax cost could be reduced to $390 million, but that would require MEAG's consent.

Subject to certain limitations and caveats, however, we have concluded that it may be possible to structure sales in a way that preserves the tax exempt and tax advantaged preferred status of the Project J bonds, by taking advantage of certain carve-outs from the "private use" restriction provided for under IRS regulations and reaffirmed in three Tax Certificates executed by JEA in connection with the PPA. These carve-outs are discussed below.

Carve-outs to Private Use Prohibition

There are number of carve-outs to the private use prohibition in the Project J Bonds, which are limited in duration or in the amount of power able to be sold without violating such prohibition. However, one carve-out provided for under IRS regulations and also specifically embodied in the Project J Bond tax certificates would allow JEA to sell electric generation service for terms of not greater than three years. Under such a carve-out, JEA could sell on all of the output under the PPA, so long as the agreements under which the output was resold were negotiated, arm's length arrangements providing for compensation at fair market value or based on generally applicable and uniformly applied rates, and limited in duration. Given these restrictions, we are exploring the implications and potential for a non-impact on the tax status of the Project J Bonds for one or more workable approaches, such as JEA holding an open auction every three years for all of the output under the PPA. We also continue to examine several other carve-outs.

Benefits

- There is no assignment of the PPA and Section 1001 of the PPA is not violated.
- JEA can engage in a private sale that meets the requirements for one or more of the carve-outs at any time. There is no requirement to notify or obtain approval from MEAG, the Project J Bond Trustee, the DOE, and/or the Collateral Agent under the DOE loan, nor is there any need to obtain approval from the PSC.
- Option 2 can be implemented unilaterally by JEA at any time and nothing precludes JEA from using both Option 2 and Option 3 and deciding whether to engage in sales to private buyers, municipal buyers, or some combination of the two each time there is a need to sell power purchased under the PPA.
- There does not appear to be any statutory bar that would prevent the PSC from approving the arrangement.

Issues

- By selling power into the market, JEA would likely incur a large economic loss, since the market value of the power purchased from MEAG is currently far below JEA's payment obligations under the PPA. J.P. Morgan has estimated the present value of the net loss to be approximately $1.45 billion. Given the downward trend in power prices, the losses could be even greater. JEA may be able to mitigate this risk, as discussed below.

- MEAG may claim that a sale to a non-public buyer breaches the covenant in Section 306 of the PPA and the Project J Bond tax certificates, which prohibit JEA from engaging in any power sale that impairs the tax exempt/tax advantaged status of the Project J Bonds. Under Section 306, to establish a breach, MEAG need only produce an opinion from outside nationally recognized tax counsel that the tax status of the MEAG bonds will be adversely effected. Based upon this provision, MEAG could attempt to block such a sale unless and until a ruling is obtained from IRS confirming that the sale qualifies for one or more of the carve-outs discussed above. We are assessing the litigation risk relating to this potential claim and will share our assessment with you as soon as it is completed. In any event, any transaction will need to be structured in a matter that enables JEA to mitigate tax exposure to MEAG and the bondholders if the aforementioned tax carve-outs are not available.

Steps to Implement

1. Because Option 1 and Option 2 are mutually exclusive,[8] a decision whether to pursue Options 2 (and/or 3) instead of Option 1 should be made before the terms and conditions of a potential transaction are finalized.

2. Negotiate and finalize sales agreements with non-public buyers.

3. A memorandum should be prepared by tax counsel assessing the scope and validity of the carve-outs and the potential risks from a tax standpoint of engaging in sales under the pertinent provisions of the IRS regulations.

4. A further analysis should be undertaken of the feasibility and potential economics of each carve-out. To conduct such an analysis, we will need to work closely with a power market expert trusted by JEA.

Option 3 – Sales to Municipal Entities

Overview

JEA retains the PPA and sells the power it is obligated to purchase under the PPA only to municipal entities.[9]

Benefits

- There is no assignment of the PPA and Section 1001 of the PPA is not violated.

- Option 3 can be implemented unilaterally by JEA at any time and nothing precludes JEA from using both Option 2 and Option 3 and deciding whether to engage in sales to private

[8] Options 2 and 3 are not mutually exclusive.

[9] As noted earlier, Options 2 and 3 are not mutually exclusive.

buyers, municipal buyers, or some combination of the two each time there is a need to sell power purchased under the PPA.

- 100% of the power will be sold directly by JEA to municipal entities, rather than to investor-owned utilities, competitive retail suppliers, or other privately-owned wholesale buyers. As a result, there is no private use and, therefore, no violation of the tax exempt/tax-advantaged status of the Project J Bonds issued by MEAG.

- There are no restrictions on JEA entering into long-term agreements to resell power, but there will need to be sufficient customers available.

- There does not appear to be any statutory bar that would prevent the PSC from approving the arrangement.

Issues

- Requiring buyers to be municipal entities significantly limits the number of potential buyers.

- By selling power into the market, JEA would likely incur a large economic loss, since the market value of the power purchased from MEAG is currently far below JEA's payment obligations under the PPA. J.P. Morgan has estimated the present value of the net loss to be approximately $1.45 billion. Given the downward trend in power prices, the losses could be even greater and, given the potential restrictions on customers inherent in Option 3, there may be further losses still. JEA may be able to mitigate this risk, as discussed below.

Steps to Implement

1. Negotiate and finalize sales agreements with public buyers.

2. To assess the feasibility of Option 3, a market expert should be retained to assess the extent of potential buyers for such sales.

Recovery through Newco

Overview

There are a number of mechanisms that could be used to recover some or all of JEA's net loss from selling power into the market in either Option 2 or 3. These mechanisms include:

- Newco making one or more termination payments to JEA for relinquishing its exclusive right to serve the relevant area;

- COJ imposing a franchise tax on Newco, which could be paid to the COJ but used as a source of funding to offset any such net loss; or

- Newco agreeing to make a support payment or pay a transition fee (some or all of which could be paid by Newco shareholders and not charged to rate payers).

PSC Approval

For Newco to be able to pass through some or all of the amount of the above payments to electricity customers, PSC approval will be required.

In general, PSCs have broad discretion to establish special charges. In any proceeding before the PSC, the central issue is likely to be the extent to which the charge will be paid by shareholders and the extent to which the charge will be passed through to rate payers. The ultimate decision on approving any passthrough will be highly political and at the discretion of the PSC and the Governor (to the extent the Governor influences the PSC and its commissioners).

Imbedded Acquisition Costs

An acquiring company more often than not imbeds in the amount it pays to the seller amounts that it does not expect to recover from rate payers. This is typically reflected through:

- buying assets above book-value, which creates an acquisition premium (not recoverable from rate payers, except in specific instances);
- rate-freezes;
- rate reductions; and/or
- rebates to customers.

Such imbedded amounts may reduce the acquisition price; however not necessarily dollar for dollar. We continue to review the utility acquisitions that have occurred during the past decade where the company being acquired had above market rates, to determine how recovery could be handled.